

**TESTIMONY
Of
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To
House Agriculture Subcommittee
General Farm Commodities and Risk Management
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Introduction

Good afternoon Mr. Chairman and Members of the Subcommittee. I am Sam Scheef, President, ARMtech Insurance Services, headquartered in Lubbock, Texas. My testimony today is presented in my capacity as the Vice Chairman of the American Association of Crop Insurers (AACI).

Thank you for scheduling this hearing in your oversight of the federal crop insurance system, which I like to think of as having five critically important and necessary elements—the farmer, the program, the private sector, the regulator and Congress. AACI, with members representing all segments of the private sector element of the crop insurance system, appreciates being invited to provide testimony and respond to questions from Members of the Subcommittee.

Mr. Chairman, my testimony will offer thoughts on two elements of the federal crop insurance system—the program and the regulator.

Federal Crop Insurance Program

The modern crop insurance program is a little over a quarter century old, although our experience with crop insurance spans more than two-thirds of a century. Mr. Chairman, your statement at a field hearing in Jefferson City, MO in late February summarizes our collective progress in providing the American farmer with a useful risk management tool very well when you said, “Crop insurance is an integral part of farming. Most farmers consider it as the centerpiece of their risk management planning and would not think of risking their livelihood and future without the coverage provided by crop insurance. The program is working for a vast majority of America’s farmers ...”

But, while the program is very good and has been highly successful in many respects, it is our conclusion the program has not reached perfection. Some challenges remain. At the Agricultural Outlook Forum 2006, Joseph W. Glauber of USDA, in presenting a comprehensive and positive report on “The Agricultural Risk Protection Act – 5 Years Later,” in addition to discussing all of the program’s accomplishments, also listed a number of challenges.

In the interest of time, I will not restate all of the accomplishments of the modern crop insurance program, including the provisions added by The Agriculture Risk Protection Act (ARPA) in 2000. Those facts have been summarized and reported on very well by USDA and others.

However, none of the reports that I am aware of has explained the fundamental characteristics of the modern crop insurance program that have made it successful. We in AACI believe the program has succeeded beyond expectations because of these fundamental characteristics:

- (1) The federal crop insurance program is a unique public-private partnership that combines the financial resources of the federal government with the operating efficiency of private sector insurance companies, reinsurers and thousands of crop insurance agents over the country. Over the past 25 years the program has evolved from an arrangement in which agents were selling government policies into a partnership where companies share the risk with the government and have their own private capital at risk. The modern crop insurance program is based on the premise that, given the proper incentives and reasonable regulation, the private sector can deliver risk management protection to America's farmers more efficiently than the federal government.
- (2) The program is based on service competition. There has been no shortage of competition in the marketplace among the approved insurance providers. However, RMA sets the premium rates, and competition is about being of service to farmers in their purchase and use of the federal crop insurance program as a farm-income risk management tool. Competition has not been about price and price-related factors, including discounts, rebates and dividends, for a very good reason—price is a market-based term and the market did not give birth to the modern crop insurance program. The modern crop insurance program is a federal program, with public policy goals and objectives. The non-price competition feature of the federal program is a major contributor to building the current level of farmer confidence that Chairman Moran spoke of.
- (3) The program is based on universal availability. While the private sector companies and reinsurers are encouraged to take risk, the federal government is willing to take most of the risk in some high loss areas. This assures that crop insurance will be available to all parts of the country, whether low-risk or high-risk. This is absolutely essential to the political viability of the program. Can you imagine what some of the members of this subcommittee would say if crop insurance were not available in their district while it was available for the same crop in other congressional districts?
- (4) The program is based on non-discrimination. Since crop insurance is a federal program, the industry must not discriminate against anyone because of race, sex, size, or any other reason. Non-discrimination means a small or limited-resource or minority farmer is equally entitled to purchase and has the same access to crop insurance as any other farmer. This also is a vital part of the political viability of the crop insurance program. We don't believe Congress would be willing to fund a program that encourages everyone in the insurance industry to compete for only the largest and most profitable farmers and deny service to smaller farmers.

To summarize these four points, the current crop insurance program works because it strikes the right balance between government resources together with government regulation and private sector initiative and ingenuity. The program has had the proper incentives for companies and agents to serve all farmers, regardless of size and location. The private sector delivery system has traditionally had incentives as well as a mandate to offer all farmers the best possible risk management advice, rather

than try to cherry-pick only the largest farmers or try to sell all farmers a GRP or GRIP policy that requires very little adjustment service.

In spite of the success that the program has enjoyed, there have been some disturbing developments recently that threaten to undermine these four principles, and thus we fear possibly the political viability of the crop insurance program. I will identify some key issues that require immediate and proper attention based on AACI membership's collective knowledge about and thousands of man-years' experience with the crop insurance program throughout its modern life. These issues must be thoughtfully considered in a comprehensive manner rather than a piecemeal approach in order for the program to continue building on its record as a dependable risk management tool for all farmers regardless of size, location, enterprise or any other characteristic.

Program Challenge: Rebates, Discounts and Dividends

The crop insurance program has a long history of treating farmers equitably regardless of which company delivers the program. Farmers receive the same policy, the same terms, the same conditions and the same rating. Since the passage of ARPA, different schemes and devices based on a company or agents' corporate business structure have entered the market place in an attempt to give agents and companies a competitive advantage. Some examples are: 1) crop insurance cooperatives have been formed with the goal of making patronage dividends to policy holders, 2) one insurance company's business plan was developed exclusively to offer discounts to policy holders, and 3) more recently, mutual insurance companies are seeking a "cooperative" designation in order to pay dividends to policy holders. AACI believes a company's or agent's corporate structure should not impact the price paid for insurance by a farmer.

Rebates historically are not allowed in insurance because of discrimination issues as well as creating a marketplace which could inadvertently undermine the financial stability of insurers. Only two states—California and Florida—allow insurance rebating and it is closely regulated within those two states. The Standard Reinsurance Agreement strictly prohibits rebating, discounts and dividends within the crop insurance program for the same reasons. However, in an ad hoc way, several avenues for discounts and dividends have crept into the federal program in recent years. Unfortunately, discounts and dividends within the crop insurance program have not been dealt with in a comprehensive way, either by Congress or the Risk Management Agency. AACI believes this issue is critical to the program and we urge Congress to address the proper role of discounts and dividends in the crop insurance program, including the regulatory role States should play.

The following are current discount authorities --

Premium Reduction Plan (PRP). In implementing its PRP programs, RMA has cited as authority Section 508(e)(3) of P.L. 103-354, the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994. Strangely, RMA chose to ignore a more recent statute that

supersedes, but does not repeal, the earlier statute. In P.L. 106-224, the Agricultural Risk Protection Act of 2000 (ARPA), Congress authorized a much more limited pilot program for premium rate reductions in Section 523(d). In this provision, the premium rate reduction plan would be carefully tailored in a limited geographical area to test the efficacy of premium reductions without jeopardizing the integrity of the program. Thus, we believe Section 508(e)(3) has been superseded by ARPA Section 523(d).

While Congress failed to repeal the very broad and general premium reduction authority of the 1994 law, it is clear that Congress felt that times had changed and that the pilot program authority was a more appropriate way to proceed on an issue that could create chaos in the delivery system. In 1994, companies were being reimbursed at a rate that averaged around 32 percent. Currently, the average rate of reimbursement is less than 21 percent. Moreover, the pilot premium rate reduction program enacted in Section 523(d) of ARPA is mandatory. ARPA required that the pilot program be initiated for the 2002 crop year.

When one very vague and permissive statutory authority is superseded by a much more specific mandatory provision, the agency should implement the mandatory one. Moreover, when a statute contains two different authorities to accomplish the same objective, it is a settled rule of statutory construction that the agency should give deference to the more recent statute.

Nevertheless, RMA first implemented a Premium Discount Program (PDP) for a single company in 2003. The PRP program allows companies with operating efficiencies to pay a discount to policy holders. The current PRP regulation allows companies to pick and choose States for discounts so it is possible to pay a discount in Iowa but not in Texas even though the efficiency may be accruing in Texas. For reinsurance year 2006, 9 of the 16 approved insurance providers have signed up for the opportunity to pay a discount under PRP. However, there is no indication of whether any of these companies will actually qualify to pay a discount, thus creating an opportunity for confusion and disappointment among farmers.

Cooperative and Trade Association Dividends – The Agricultural Risk Protection Act (ARPA) authorized cooperatives and trade associations that receive a payment from insurance providers to provide benefits to their members from the funds received by insurance providers (Section 508(b)(5)(B)). Moreover, ARPA ties any payments made by cooperatives and trade associations to review and approval by State regulators. This provision of law is used by cooperatives, such as the Farm Credit Banks, to make patronage dividend payments to their members.

RMA has issued a Manager's Bulletin (MGR-01-024) in an attempt to regulate this provision of law. It has not issued a regulation for public comment. Since the issuance of the Manager's Bulletin, some cooperatives have been formed with the apparent sole intent of making patronage dividend payments to their members based solely on crop insurance premiums. Most recently, an insurance provider has sought a "cooperative" designation in order to make dividend payments to its members without the necessity of going through an existing cooperative. RMA is trying to accommodate this request.

AACI believes that Congress set forth a narrow exception to the prohibition against rebates in Federal crop insurance to allow payments "to the cooperative association or trade association." This statute

makes no allowance for a single entity, a crop insurance provider to make payments directly to policyholders. The statutes require two separate entities, an insurance company and a separate cooperative. Any attempt to characterize payments from the insurance company (as an insurance company) to itself (as a cooperative) for later payment to the policyholder as a dividend is simply a conduit designed to circumvent the law and is a “sham” transaction with no economic, accounting, or factual reality.

Performance-Based Discounts – As an alternative to rebates, AACI would support Performance-Based Discounts. Performance-based discounts were a program component in the 1980s. When RMA instituted the Average Production History (APH) program, performance based discounts were phased out. ARPA reauthorized these discounts in Section 101 (b). AACI believes performance-based discounts are the most equitable and least discriminatory method of providing crop insurance discounts to farmers. In addition, they would give farmers across the country a chance at a discount, which is far preferable to allowing discounting only for one company or a handful of companies who might concentrate on discounts at the expense of service to farmers. Unfortunately, this provision of law has not been implemented to date.

Role of the States – Traditionally the States have regulated insurance programs. Certain aspects of the state role are preempted within the crop insurance program, for example the discount authorized by PRP program. Other aspects of the crop insurance program are left to the States to regulate such as agency licensing and dividends and rebates allowed under 508(b) (5(B). The companies in actuality must respond to both regulators, RMA and the States. The role of the states with regard to discounts, dividends and rebates need to be clarified.

Request for the Committee to Halt PRP and the RMA to Halt Dividend Discounts

We recommend The House Agriculture Committee take action to halt the implementation of Section 508(e)(3), the referenced authority for the PRP program, until a full and complete impact analysis of PRP and other discount programs is conducted. Discounts and dividends may have a role in the crop insurance program, but the ability of RMA to regulate discounts and dividends, the proper role of State regulators and the need to ensure that corporate structure not determine eligibility must be addressed in a comprehensive manner. We note that language was included in the FY06 Agriculture Appropriation Bill to halt the PRP program for the 2007 crop reinsurance year. Similar action may be the most expedient means to halt PRP for the 2008 crop reinsurance year if this Committee determines it will not be possible to pass separate legislation this year.

For the reasons previously stated, we have also requested RMA to disallow any request by an insurance provider to declare itself a cooperative and pay dividends directly to farmers.

The Regulator – The Risk Management Agency (RMA)

The second element of the federal crop insurance program that I want to touch on in my testimony is the regulator – RMA. The federal crop insurance program needs an effective regulator to continue growing and developing in value to all farmers, ranchers and growers, while earning and maintaining the trust and support of Congress and the public.

Today's complex crop insurance program is growing more complex with each passing year. With this increasing complexity comes an ever increasing regulatory challenge for RMA. The main challenge of RMA is to manage and regulate a growing program that yearly becomes a more essential component of the financial infrastructure of American agriculture while not greatly increasing its budget.

With the budget deficits that our government now faces, RMA must focus on the rebalancing of resources and prioritizing its goals. We in the private sector are forced to do this every year. As the program changes and new and different objectives and mandates are added, resources must be redirected to reflect the new priorities. To maintain an acceptable level of effectiveness there is one resource that must keep pace with change and that is information technology. RMA badly needs to upgrade its computer technology in order to communicate effectively and efficiently with its private sector partners.

We propose that RMA make its computer technology needs a top priority and find the funds necessary to modernize by reordering other missions and seeking new appropriations. We are willing to work with the agency in this regard and support them in the appropriations process. However, RMA should focus its information technology upgrade on its internal systems and on its role as a regulator. Some within RMA are attempting to duplicate the private sector role by developing direct user interfaces to farmers, a role which should properly be reserved for insurance companies and agents.

Using my company as an example of what I know to be the situation generally for RMA's private sector partners in the crop insurance program, we have invested heavily in establishing the best information technology available and we continuously add to the investment in order to maintain maximum capabilities. We depend on information technology not only to be on the leading edge of processing and operational efficiencies but also to provide our farmer-customers with the best possible services. RMA must become an equal with its private sector partners in the use of information technology. RMA is not there today.

In this regard, AACI commends the House Agriculture Committee for the position it has taken for no reductions in the FY07 budget for agriculture and we appreciate the action taken to inform the Budget Committee of its views. Additionally, and for the record, we are absolutely opposed to the creation of a "premium tax" or "participation fee," as it is referenced in the administration's proposed budget. The Risk Management Agency (RMA) is a federal entity, established to administer and regulate the federal crop insurance program—a public policy justified, developed and supported on the basis that benefits accrue to a broad cross section of the general population. Accordingly, all funds necessary for RMA to carry out its mission and purpose should be appropriated from the general funds of the U.S. treasury.

Finally, RMA should return to a more traditional form in its relationship with the private sector. We are encouraged by the reception and attitude regarding this possibility by the new management team. A more cooperative relationship, while maintaining all of the necessary conditions of an arms-length regulator, can serve to reduce demands on RMA's limited resources, allowing greater funding for top priority needs, especially computer technology.

In summary, we believe RMA management should reexamine the four unique features that I outlined at the beginning of the statement--- (1) the unique public-private partnership, (2) service-based competition, (3) universal service to all farmers, and (4) non-discrimination against any farmers. RMA's priority should be building on these critical reasons for the program's success rather than creating or allowing new marketing gimmicks such as PRP that serve only to divert the focus and resources of the agency, as well as the private sector, and result in less service to the people the program was created to serve—the American farmers.

This concludes my statement, Mr. Chairman. I will be happy to respond to questions at the appropriate time.